"Catching up with consumer realities: the need for legislation prohibiting unfair terms in consumer contracts"

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Abstract

In the policy debate about the need for legislation to prohibit the use of unfair terms in consumer contracts, *substantive unfairness* is often distinguished from *procedural unfairness*. Current consumer protection laws appear to offer the potential for relief on substantive unfairness grounds alone, however, a review of cases involving credit contracts shows this potential is rarely realised. This reluctance to provide relief for substantive injustice reflects a pre-occupation with freedom and certainty of contract, the notions underpinning classical contract theories. As a class, consumers are vulnerable in the marketplace, and they do need protection from substantively unfair terms. A new framework for regulating consumer contracts is needed, one that relies less on classical contract theories and takes the reality of consumer contracting and consumer behavior as its starting point. Unfair contract terms legislation will be a step on the path towards this new framework.

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Introduction

Over recent years, Fair Trading Ministers and agencies in Australia have been considering whether there is a need for legislation to prohibit or regulate unfair terms in consumer contracts. In January 2004, the Standing Committee of Officials of Consumer Affairs (SCOCA) released a discussion paper on the issue, proposing five options for consideration and comment.[1] This follows the successful implementation of unfair contact terms legislation in Victoria;[2] this in turn was modeled on legislation in the United Kingdom and Europe.[3] In September 2005, the State and Territory Ministers responsible for fair trading 'reaffirmed their agreement to progress a national regulatory response to unfair contract terms as a matter of urgency',[4] however, this sense of urgency now seems to have abated.[5]

The impetus for unfair contract terms legislation in Australia reflects concern about the impact of changes in consumer markets, including the proliferation of standard form consumer contracts, and concern that the current regulatory framework does not provide adequate relief from *substantive* unfairness in consumer transactions. A major thesis of this article is that the failure of the current regulatory framework to deal adequately with substantive unfairness in consumer transactions results from the stranglehold that classical contract law theories have had over the development and

[1] Standing Committee of Officials of Consumer Affairs *Unfair Contract Terms: A Discussion Paper* (January 2004).
[2] *Fair Trading Act 1999* (Vic), Part 2B.
[3] *Unfair Terms in Consumer Contracts Regulation 1999* (UK); *Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts* (European Council).
[4] Joint Communiqué Ministerial Council on Consumer Affairs Meeting, Friday 2 September, http://www.consumer.gov.au/html/joint_communique/jointcommunique_september2005.htm, viewed 10 October 2005.
[5] In their May 2006 meeting, the Ministers noted that the States and Territories are continuing to seek nationally consistent legislation in this area, but that the work will be progressed out of session: Joint Communiqué Ministerial Council on Consumer Affairs Meeting, Tuesday 16 and Wednesday 17 May 2006, http://www.consumer.gov.au/html/joint_communique/jointcommunique_may2006.htm, viewed 22 May 2006.

interpretation of consumer protection legislation. This has almost inevitably led to a focus on issues of procedural impropriety, rather than substantive unfairness or injustice.

This article is therefore concerned with the notion of substantive unfairness or injustice; a concept that can and should be distinguished from procedural unfairness or injustice.[6] In essence, substantive unfairness is about the substance of the terms of the transaction, rather than the individual circumstances under which the transaction came about (the procedural issues). In its broadest sense, substantive unfairness can be assessed on the face of the contract itself, without needing to have regard to the characteristics and actions of the parties to the contract. Case law and commentary tend to distinguish substantive from procedural injustice. For example:

> a contract may be unjust under the [Contracts Review] Act because its terms, consequences or effects are unjust. This is substantive injustice. Or a contract may be unjust because of the unfairness of the methods used to make it. This is procedural injustice. Most unjust contracts will be the product of both procedural and substantive injustice.[7]

In the SCOCA discussion paper referred to above, substantively unfair terms are defined as 'those terms in a contract which are to the disadvantage of one party (usually the purchaser of goods or services) but which are not reasonably necessary for

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[6] The Victorian Bar Council has suggested that the distinction 'is illusory and in fact unnecessary' Victorian Bar Council *Unfair Contract Terms Discussion Paper 2004: Submission of the Victorian Bar* (2004) p 2, http://www.fairtrading.qld.gov.au/oft/oftweb.nsf/AllDocs/CB0A9D21A156FEDF4A256ED1000ADCC7/$File/Subm%20VicBar(65).pdf, viewed 25 October 2005. See also Phang A, "Security of Contract and the Pursuit of Fairness" (2000) 16 *Journal of Contract Law* 158, at 162.

[7] *West v AGC (Advances) Ltd and Others* (1986) 5 NSWLR 610 at 620.

the protection of the legitimate interests of the other party (usually the supplier)'.[8] The paper provides examples of potentially unfair terms, including:

- Terms in a holiday package contract that grant the supplier the right to alter most aspects of the holiday without notice, or exclude liability for the supplier's failure to honour verbal and written representations made;
- Terms in a car hire contract that allow the supplier to claim damages from the consumer for failure to meet the conditions of the agreement without any reference to reasonableness or the supplier's duty to mitigate its loss; or which give the supplier the unqualified right to repossess the vehicle;
- Terms in a telephone contract that authorise the supplier to complete, on behalf of the purchaser, any part of the form not completed by the purchaser, and require the purchaser to agree to be bound by the completed form; or that provide for certain additional terms to apply to special promotions and offers, but with such terms only being made available on the request of the purchaser.[9]

Often, substantive injustice will point to the existence of procedural injustice,[10] or vice versa. However, there are also circumstances where the existence of substantive injustice or unfairness alone should entitle the consumer to relief, even in the absence of procedural irregularities.

[8] SCOCA, n 1, p 14.
[9] SCOCA, n 1, p 14-15.
[10] In *Chapman v Batman* [2004] NSWSC 2 (3 February 2004) at [23], the Court noted that 'the essentially one sided nature of the contract makes it more likely than not that the plaintiff was unfairly induced to enter it'.

In Australia, the debate about the need or otherwise for unfair contract terms legislation has largely been carried out in the policy arena, through the discussion paper referred to above, and the large number of submissions provided in response. More recently, it has become the subject of academic comment.[11] This article explores further some of the legislative, policy and theoretical issues surrounding the regulation of substantive unfairness, with a view to demonstrating the need to discard the omnipresent classical contract theories when dealing with consumer transactions.

To place the theory and thesis in context, this article begins by outlining the current legislative and equitable provisions that might be used to provide relief for substantive, as well as procedural unfairness. These include prohibitions against unconscionable conduct, unjust contracts, and unjust transactions. The statutory provisions do not explicitly prevent substantive injustice alone being grounds for relief, and the article reviews relevant cases to find that there have been some cases where it appears that substantive issues have been the sole or primary criteria for providing relief. However, these cases are few and far between, and uncertain in their precedent value. It seems therefore that, despite initial expectations that the more recent protections might assist in dealing with substantive unfairness, these expectations have largely been thwarted by the reverence given by the courts to notions of freedom and sanctity of contracts, even where the contract is offered on a 'take it or leave it' basis.

[11] See, for example, Griggs L, "The [ir]rational consumer and why we need national legislation governing unfair contract terms" (2005) 13 *Competition and Consumer Law Journal* 1; Zumbo F, "Dealing with unfair terms in consumer contracts: Is Australia falling behind?" (2005) 13 *Trade Practices Law Journal* 70.

This article then summarises some of the consumer protection theories that give a basis for intervening in consumer contracts, and the reasons why an effective response to substantive unfairness is necessary. It is suggested that the strict application of classical contract theory has been whittled away by statutory protections such as the prohibitions against unconscionable conduct. However, this tinkering at the edges of classical contract theory has not enabled an adequate or comprehensive response to the issues faced by consumers today, and that a new framework is needed, one that takes the reality of consumer contracting as its starting point. In light of the conclusions that legislation to prohibit substantive unfairness is needed, and that the current law is uncertain in its ability to provide such relief, some reforms that would both meet the needs and expectations of consumers in their dealings with businesses, and minimise any interruptions to certainty for businesses, are suggested.

Although substantively unfair terms can be found in all types of consumer contracts, this article focuses on specific examples and legislation application to consumer credit contracts, because it is in this sector that many complaints about unconscionable conduct and unjust transactions/contracts are made.[12]

Contract law and consumer protection provisions

Consumer contracts are primarily governed by the common law of contract, and, in general, and in the absence of vitiating factors, contracts will be enforced by a court where there is agreement between the parties about the terms of the contract, the

[12] A number of the leading cases on unconscionability / unjust contracts involve credit contracts: for example, *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447; *Garcia v National Australia Bank Ltd* (1998) 194 CLR 395; *West v AGC (Advances) Ltd* (1986) 5 NSWLR 610.

parties intend to be legally bound by their agreement, and there is valuable consideration passing pursuant to the contract.[13]

In applying contract law principles, the notions of freedom of contract and certainty of contract are given priority.[14] It is assumed that the terms of the contract reflect the will of the parties, and that it is therefore inappropriate to examine the terms of the contract and make any judgments about whether those terms are harsh or one-sided.[15] However, in more recent times, the distinct position of consumers in their dealings with traders has been recognised, and a number of specific statutory and equitable provisions and principles have been introduced or developed to temper what might be the otherwise harsh effect of the strict application of contract law principles to consumer transactions. These include the equitable principle of unconscionability; and provisions in the *Australian Securities and Investments Commission Act 2001* (Cth), *Contracts Review Act 1980* (NSW), and *Uniform Consumer Credit Code 1996*.

The equitable doctrine of unconscionability has been developed in Australia through cases such as *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447. The elements of this doctrine require one party to take advantage of another party who has a 'special disadvantage', and involves a strong focus on the conscience and behaviour of the trader and on procedural unfairness. If the contract is substantively unfair, but

[13] For example, Khoury D and Yamouni YS, *Understanding Contract Law* (6th ed, LexisNexis Butterworths, 2003) p 12.
[14] For example, Phang, n 5 at 158; Zumbo, n 10 at 71.
[15] For example, Goddard summarises four justifications for interfering in freedom and certainty of contract, and none of these justifications involve existence of harsh or one-sided terms alone: Goddard D, "Security of Contract: Why it Matters and What that Means" (2000) 16 *Journal of Contract Law* 123 at 135.

there is no procedural 'taking advantage of', then there is no unconscionability.[16] It would be difficult, therefore, to rely on equitable unconscionability to provide relief for substantive injustice in circumstances where there is not also procedural injustice.[17]

Various consumer protection statutes in Australia prohibit unconscionable conduct. For consumer credit transactions, the most relevant statutory provisions are found in the *Australian Securities and Investments Commission Act 1989* (Cth) (ASIC Act). Section 12CA prohibits conduct that is unconscionable 'within the meaning of the unwritten law, from time to time, of the States and Territories', and s 12CB spells out a statutory form of unconscionable conduct. The factors that the Court may have regard to in assessing whether conduct is unconscionable under s12CB are primarily procedural factors,[18] but they also include some substantive factors.[19]

The *Contracts Review Act 1980* (NSW) (CRA) can also be used by consumers seeking relief from substantive unfairness, at least in NSW. Section 7(1) allows a Court to give relief from a contract or provision of an unjust contract. Relief can include a refusal to enforce any or all of the provisions of the contract, an order declaring the contract void in whole or in part, and an order varying any provision of the contact. Section 9 spells out the matters that the Court must have regard to when

[16] Dal Pont G, "The Varying Shades of "Unconscionable" Conduct – Same Term, Different Meaning" (2000) 19 *Australian Bar Review* 135 at 138: 'it is in exploiting the weaker party's known special disadvantage that the stronger party behaves unconscionably'.
[17] See also Peden JR, *The Law of Unjust Contracts* (Butterworths, 1982), p 25: "The English and Australian courts have concentrated their attention for the most part in the area of procedural unconscionability."
[18] Including the parties' relative bargaining strengths (*Australian Securities and Investments Commission Act 2001* (Cth) s 12CB(2)(a)); whether person was able to understand the contracts (s 12CB(2)(c)); and the existence of undue influence, pressure or unfair tactics (s 12CB(2)(e)).
[19] *Australian Securities and Investments Commission Act 2001* (Cth), ss 12CB(2)(b), and 12CB(2)(e).

assessing injustice, where they are relevant. This 'shopping list' includes a mix of substantive and procedural factors, and substantive factors include:

> (d) whether or not any provisions of the contract impose conditions which are unreasonably difficult to comply with or not reasonably necessary for the protection of the legitimate interests of any party to the contract,[20] and
>
> (g) where the contract is wholly or partly in writing, the physical form of the contract, and the intelligibility of the language in which it is expressed.[21]

In the case of consumer credit contracts, the *Uniform Consumer Credit Code 1996* (UCCC) (implemented nationally) may also be of assistance. Under s 70(1), a debtor, mortgagor or guarantor can ask the Court to 're-open' an unjust transaction. In determining whether a transaction is unjust, the Court must have regard to the public interest and to all the circumstances of the case.[22] The Court may also have regard to a 'shopping list' of factors set out in s 70(2), and some of these appear to point to issues of substantive, rather than procedural, injustice, for example:

> (e) whether or not any of the provisions … impose conditions that are unreasonably difficult to comply with, or not reasonably necessary for the protection of the legitimate interests of a party;
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> (m) whether the terms of the transaction … is justified in light of the risks undertaken by the credit provider;
>
> (n) the terms of other comparable transactions involving other credit providers.

[20] *Contracts Review Act 1980* (NSW), s 9(2)(d).
[21] *Contracts Review Act 1980* (NSW), s 9(2)(g).
[22] *Consumer Credit Code*, s 70(2).

With the exception perhaps of equitable unconscionability, each of the statutory protections summarised here could potentially be used to seek relief from an unfair term or terms in a consumer contract. There is no specific requirement in the statutory provisions that procedural unfairness must be involved before relief can be granted, and the 'shopping lists' contained in each piece of legislation include at least some factors that point to a concern with substantive unfairness alone. And, at least in the case of the CRA, the term 'unjust contract' was deliberately chosen so that Courts would be able to interpret the legislation free from the influence of the unconscionability doctrine and its developments.[23]

However, this potential does not seem to have been realised. For example, in assessing claims under the statutory provisions against unconscionable conduct, the courts have been strongly influenced by the approach taken in the equitable jurisdiction, with its focus on procedural, rather than substantive, issues.[24] A similar situation appears to have arisen in the context of the CRA. In 2001, Carlin analysed 60 cases decided under the CRA between 1982 and 2000, and he noted that:

> in only one of 18 mortgage or guarantee cases in which relief was granted and to which a financial institution was a party was a contract held to be unjust by reason of the harshness or oppressiveness of the terms of the contract itself.[25]

[23] Carlin TM, "The Contracts Review Act 1980 (NSW) – 20 Years On" (2001) 23 *Sydney Law Review* 125, at 129.
[24] Zumbo, n 10 at 83.
[25] Carlin, n 22 at 133, referring to *Cook v Bank of New South Wales* [1982] ASC 55-223 . However, in that case, the judge did not make a firm finding that the term (providing that a certificate as to the amount owing was conclusive against the mortgagor) was unjust because the matter was not fully argued (at [57,060]).

In another article reviewing CRA cases, Zipser has suggested that the observation of McHugh J, that 'most unjust contracts will be the product of both procedural and substantive injustice', has been proven correct.[26]

A review of consumer credit cases

This section examines the extent to which the statutory provisions discussed above have in fact been used to provide relief for substantive injustice in consumer credit cases. This article is not a comprehensive analysis of all cases decided under the relevant statutory provisions. Instead, after reviewing recent cases that involved at least some elements of substantive injustice, a sample of those cases have been chosen to illustrate the extent to which substantive injustice alone is a sufficient reason for Courts to provide relief, and also to illustrate some of the different (and non-exclusive) types of substantively unfair terms that can be found in consumer credit contracts. These include:

- terms or contracts where the price or cost is unfair or unjust;
- credit contracts structured so as to result in unjust outcomes;
- terms that are unnecessary for the protection of the legitimate interests of the trader; and
- credit contracts where the borrower does not have the capacity to meet the terms of the contract, or to meet the terms without substantial hardship.

[26] Zipser B, "Unjust Contracts and the Contracts Review Act" (2001) 17 *Journal of Contract Law* 76, at 79.

Analysing whether these statutory provisions have been successful in providing relief for substantive injustice is not as simple as it sounds. The cases do not always clearly distinguish between substantive and procedural issues. Where cases involve both procedural and substantive issues, it is difficult to predict what the result might have been if the procedural element was absent. Also, the 'shopping list' approach does not give any guidance as to the weight to be given to any particular factor.[27] Nor does it suggest whether or not proof of one factor alone will be sufficient to grant relief. The analysis that follows is therefore subjective, and others may come to different views.

Unjust terms as to price or cost

Traditional contract theory tells us that contractual bargains should not be upset simply because the price is above market price or normal price, or a 'bad bargain'.[28] However, a review of cases indicates that there may be two limited circumstances where an unfair price, fee or charge might be sufficient to found a remedy.

The first circumstance is where a fee or charge has not been properly imposed. In *McNally v Australia and New Zealand Banking Group* (2001) ASC 155-047 the Fair Trading Tribunal in NSW found that a term in the contract that permitted deduction of enforcement expenses that were not properly 'enforcement expenses' was unjust pursuant to s 70(2)(a) of the UCCC.[29] However, the Tribunal took the view that the relief sought (a re-opening of the contract) was unnecessary because it had earlier ordered that the relevant 'costs' be re-credited to the plaintiff's loan account.[30]

[27] Duggan A and Lanyon E *Consumer Credit Law* (Butterworths, 1999) p 367; Carlin, n 22 at 136.
[28] *Citicorp Australia Ltd v O'Brien* (1996) 40 NSWLR 398 at 420.
[29] *McNally v Australia and New Zealand Banking Group* (2001) ASC 155-047 at [200,461].
[30] *McNally v Australia and New Zealand Banking Group* (2001) ASC 155-047 at [200,462].

Similarly, in *McKenzie v Smith* (1998) ASC 155-025 the contracts imposed prohibited interest charges, and the Commercial Tribunal held that 'to impose void and recoverable amounts is unjust'.[31]

A second circumstance may be where the price is excessive compared to the market price, or the expected cost. In *Dale v Nichols Constructions Pty Ltd* [2003] QDC 453, the District Court in Queensland considered, among other things, whether the interest rate on a loan was such that it would assist an argument that the transaction was unjust under s 70. Although the Court found that the contract was not unjust in this case,[32] the judge also seemed willing to entertain a notion that an unreasonably high interest rate might be indicative of an unjust contract:

> If it [the interest rate] had been 20 per cent interest for three months and 133 per cent interest thereafter, I think the contract would have been unjust, but that was not the situation.[33]

In an earlier case of *Espiritu v Australian Guarantee Corporation Ltd (1997)* ASC 155-004 the NSW Commercial Tribunal made short shrift of the applicant's argument that the insurance amount was 'a grossly excessive amount',[34] explaining that 'it is not satisfied … that the amount is grossly excessive', after referring to possible premiums from comparable insurers.[35] However, the Tribunal seems to leave open the

[31] *McKenzie v Smith* (1998) ASC 155-025 at 148,607.
[32] "The interest rate was quite high but the respondent was simply taking advantage of the extreme willingness of the applicant to enter the transaction": *Dale v Nichols Constructions Pty Ltd* [2003] QDC 453 at [106].
[33] *Dale v Nichols Constructions Pty Ltd* [2003] QDC 453 at [106].
[34] *Espiritu v Australian Guarantee Corporation Ltd (1997)* ASC 155-004 at 148,253.
[35] *Espiritu v Australian Guarantee Corporation Ltd (1997)* ASC 155-004 at 148,253.

possibility that relief might be appropriate if the amount had been 'grossly excessive'.[36]

In *Vakele Pty Ltd v Assender* (1989) NSW ConvR 55-467, the NSW Supreme Court found that there was no procedural injustice, and it had to decide whether the CRA was applicable 'merely because there is an undervalue [of the property] by between 15 and 32 per cent'.[37]

Young J reviewed earlier cases, including *West v AGC (Advances) Ltd* (1986) 5 NSWLR 610, and suggested that the main thrust of the CRA:

> is against the procedural injustice in allowing persons to harry someone into making a contract or to substantive injustice in the contract itself, mainly where there are terms in the contract which are harsh and oppressive. Although *where there is an horrendous disparity between market price and contract price, the case may come within the substantial injustice concept*, that is not the ordinary case of substantial injustice.[38] (emphasis added)

However, the fact that the price was below the market value by 15% or even 32% was not alone enough to say that there was an unjust consequence caused by an unjust contract. The Court did not grant relief.[39]

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[36] For example, 'it is not unreasonable to expect that a person might decline to purchase a vehicle if they were aware that the annual insurance premium was approximately equal to one-third of the cost of the vehicle being purchased. This is particularly the case if such a purchaser was required to pay interest on the premium at an annual rate of 22.75%', *Espiritu v Australian Guarantee Corporation Ltd (1997)* ASC 155-004 at 148,254.
[37] *Vakele Pty Ltd v Assender* (1989) NSW ConvR 55-467 at 58,381.
[38] *Vakele Pty Ltd v Assender* (1989) NSW ConvR 55-467 at 58,382.
[39] *Vakele Pty Ltd v Assender* (1989) NSW ConvR 55-467 at 58,382.

A finding in the other direction was made in the case of *Guardian Mortgages v Miller* [2004] NSWSC 1236. In this case, the NSW Supreme Court found that a clause setting damages for late payment at $15,000 bore 'no relationship whatsoever to any loss that could not be otherwise recoverable under the mortgage', and should be severed from the contract.[40]

It is interesting to contrast *Vakele* with *Baltic Shipping Company v Dillon "Mikhail Lermontov"* (1991) 22 NSWLR 1, where the trial judge found that the provisions of a settlement agreement were unjust because of the disparity between the plaintiff's entire claim and the settlement amount.[41] On appeal, however, at least Gleeson J seemed to suggest that a substantial disparity alone would *not* be enough. He noted that people often settle legal claims for less than what they are worth, and suggested that such a calculated decision is not enough to ground relief under the CRA.[42]

Thus, while at least some decisions have seemed to entertain the possibility that an horrendous price will be sufficient to provide relief, even in the absence of procedural unfairness, [43] in practice, that barrier seems to be rarely (if ever) reached.

Contracts structured so as to result in unjust outcomes

A second category of cases examined is where the contract or transaction is structured in such a way that an unjust outcome is inevitable. *McKenzie v Smith* (1998) ASC 155-

[40] *Guardian Mortgages v Miller* [2004] NSWSC 1236 at [109]-[111].
[41] *Baltic Shipping Company v Dillon "Mikhail Lermontov"* (1991) 22 NSWLR 1 at 17 (Kirby J), quoting trial judge.
[42] *Baltic Shipping Company v Dillon "Mikhail Lermontov"* (1991) 22 NSWLR 1 at 9. However, the court did find procedural injustice and granted relief: Kirby J at 21, Gleeson J at 9.
[43] In *West v AGC*, the majority also noted the relevance of normal commercial arrangements in assessing substantive injustice: "it was not suggested that the rate of interest or any relevant provision … departed from what was normal in an ordinary commercial borrowing of this nature", *West v AGC (Advances) Ltd* (1986) 5 NSWLR 610 at 619.

025 involved two applications relating to 'vendor terms' contracts, where the applicants purchased homes on instalment terms, obtaining no legal interest in the property until all instalments were paid. In finding that the contracts were unjust, the Commercial Tribunal took a broad look at the contracts and the circumstances, and then reviewed each of the s 70(2) factors in turn. The substantive factors that resulted in the contracts being said to be unjust included:

- The structure of the transactions 'posed risks for the purchasers', in that if the vendor defaulted on loan repayments to a third party, the purchasers might be subject to interference with their home possession by that third party.[44]
- The contracts imposed prohibited interest charges.[45]
- The purchasers on default did not get any set off or benefit from early payments; and would forfeit any moneys already paid if they default; and the vendor could create embraces over the land to a third party, without the purchasers' knowledge or consent.[46]
- '... the form of the instalment contract creates problems'; by adapting, without regard to the UCCC, the standard forms of contracts for land of the Law Society of NSW, the transactions were given an appearance of legality.[47]

Aspects of procedural injustice were also involved.[48] However, it seems that the substantive elements played a very significant role in the decision. For example, in

[44] *McKenzie v Smith* (1998) ASC 155-025 at 148,607.
[45] *McKenzie v Smith* (1998) ASC 155-025 at 148,607.
[46] *McKenzie v Smith* (1998) ASC 155-025 at 148,608.
[47] *McKenzie v Smith* (1998) ASC 155-025 at 148,608.
[48] For example, the lack of independent legal advice; the fact that the vendor acted for both himself and the purchasers; the superior bargaining power of the vendor; the lack of explanation of the legal and practical effects; a lack of negotiation on the contract terms; and the vendor did not make enquiries as to the purchasers' capacity to pay (*McKenzie v Smith* (1998) ASC 155-025 at 148,608).

talking about the structure of the transaction (the substantive elements), the Tribunal noted that '[t]hose facts or factors point to unjust contracts; … they do have determinative weight'.[49]

Lewis v Ormes (Commercial) [2005] NSWCTTT 481 (18 July 2005) also concerned a vendor terms contract, and in this case the Tribunal commented unfavourably on the clause in the contract that allowed the vendor to retain any instalments paid if the borrowers defaulted.[50] The Tribunal found that the transaction was unjust, and ordered that compensation be paid to the borrowers.[51] There were also some procedural factors present in this case.[52] but the impact that they had on the decisions is not clear.

In *Elders Rural Finance Ltd v Smith* (1996) 41 NSWLR 296, the plaintiffs were members of a farming family who took on the purchase of a property that ultimately turned into 'an investment disaster'.[53] The trial judge found that:

> None of the Smiths had any experience or capacity which could equip them to make a projection for several future years, let alone for 10 years of the capacity of a business to generate enough cash to meet the obligations involved.[54]

The trial judge found that the consequences and effects of the finance contract amounted to substantive injustice, and granted relief.[55] Key factors considered under

[49] *McKenzie v Smith* (1998) ASC 155-025 at 148,607.
[50] *Lewis v Ormes (Commercial)* [2005] NSWCTTT 481 (18 July 2005) at [28].
[51] *Lewis v Ormes (Commercial)* [2005] NSWCTTT 481 (18 July 2005) at [28], [34].
[52] *Lewis v Ormes (Commercial)* [2005] NSWCTTT 481 (18 July 2005) at [28].
[53] *Smith v Elders Rural Finance Ltd* [1994] Supreme Court of NSW, 1117 of 1993, BC9403281 (unreported, Bryson J, 25 November 1994) at [10].
[54] *Smith v Elders Rural Finance Ltd* [1994] Supreme Court of NSW, 1117 of 1993, BC9403281 (unreported, Bryson J, 25 November 1994) at [17].

s 70 included paragraph 2(d): 'it was unreasonably difficult to comply with the conditions relating to the payment of capital and interest, not because of any aspect of the terms of the contract in themselves, but because of the circumstances in which they were imposed'[56] and paragraph 2(l): 'viewing the contract in its commercial setting, it is unjust that the contract of loan was ever made …'[57]

However, on appeal, the majority also found elements of procedural injustice, including the facts that Elders Rural Finance ('Elders') knew of, and appreciated the risks to the plaintiffs; and Elders knew that the Smiths did not appreciate the risks, but placed some trust in Elders.[58] The combination of procedural and substantive elements was sufficient for the majority to find the contract unjust and to provide relief. [59]

Two other cases decided under the CRA highlight the possibility that the structure of a transaction might lead to injustice.

In *Goldsbrough v Ford Credit Aust. Ltd* (1989) ASC 55-946, the substantive matters of concern included the above average likelihood of guarantee being called upon, the loading in the insurance premium in the finance contract, and lending of 133% of value of goods – all matters that could be described as the structure of the

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[55] *Smith v Elders Rural Finance Ltd* [1994] Supreme Court of NSW, 1117 of 1993, BC9403281 (unreported, Bryson J, 25 November 1994) at [48].
[56] *Smith v Elders Rural Finance Ltd* [1994] Supreme Court of NSW, 1117 of 1993, BC9403281 (unreported, Bryson J, 25 November 1994) at [48].
[57] *Smith v Elders Rural Finance Ltd* [1994] Supreme Court of NSW, 1117 of 1993, BC9403281 (unreported, Bryson J, 25 November 1994) at [48].
[58] *Elders Rural Finance Ltd v Smith* (1996) 41NSWLR 296 at 302 – 303.
[59] In contrast, Meagher J (dissenting) found that there were no procedural injustices in the case, as the Smiths were not deprived of real, informed choice. Meagher also took the view that there was no substantive injustice – there was nothing unjust or unreasonable in the terms of the contract. *Elders Rural Finance Ltd v Smith* (1996) 41NSWLR 296 at 304.

transaction.[60] In this case, there was also a procedural element – the failure of the lenders to drawn these substantive issues to the guarantors' attention.[61] Relief was granted.[62]

In *Abram v Bank of New Zealand* (1996) ATPR 41-470, the Court examined standard terms in a mortgage contract, including a term that resulted in the mortgage securing all other debts, including the parties' credit card debts. The Court took the view this clause *was* unjust,[63] and the substantive injustice of the various clauses was compounded by the fact that there was no information provided to the debtors that the relevant clauses existed (a procedural matter).[64] However, the Court declined to grant relief.[65]

These cases suggest that there may be some circumstances in which Courts will grant relief on the grounds of substantive injustice alone, where the terms of the agreement are structured so that an unjust outcome is inevitable.

Terms unnecessary for the protection of the legitimate interests of the trader

A third category of substantive injustice is where terms are considered unnecessary for the protection of the legitimate interests of the trader – where the terms are regarded as a case of 'overkill'.[66] A case in point is *Esanda Finance Corporation Ltd v Tong*

[60] *Goldsbrough v Ford Credit Aust. Ltd* (1989) ASC 55-946 at 58,590-91.
[61] *Goldsbrough v Ford Credit Aust. Ltd* (1989) ASC 55-946 at 58,590.
[62] *Goldsbrough v Ford Credit Aust. Ltd* (1989) ASC 55-946 at 58,591.
[63] *Abram v Bank of New Zealand* (1996) ATPR 41-470 at 41,781.
[64] For example, the covering letter to the standard terms did not 'hint that the entire amount owed must be paid on demand' (*Abram v Bank of New Zealand* (1996) ATPR 41-470 at 41,779) and contained 'no intimation that notwithstanding what is said in the letter or implied by its terms, the enclosed standard terms might be inconsistent with what was clearly conveyed by the letter …(at 41,779-80).
[65] *Abram v Bank of New Zealand* (1996) ATPR 41-470 at 41,780-81.
[66] *In the Marriage of Ryan* (1992) 16 Fam LR 826 at 836.

(1997) 41 NSWLR 482. This involved a joint business venture where the directors had entered into an equipment lease with Esanda, secured by personal guarantees and a mortgage over the home of one of the directors (Tran). Differences subsequently arose; Tran resigned and sought a discharge of the mortgage. Tong (and his wife) agreed to give Esanda a mortgage over their home in replacement, despite having no financial or other interest in the joint venture.

The NSW Court of Appeal found that the contract was unjust in a substantive sense because, in replacing the original security, limited to $105,000, Esanda received a guarantee unlimited as to amount:

> The officers of Esanda thus took the opportunity to improve its security but did so surreptitiously, in a manner not likely to bring the change to the attention of the Tongs …. The officers of Esanda must also have realised that an express request for additional security would almost certainly have been rejected by the Tongs who had no reason to accept greater risks than the Trans.[67]

The Court therefore affirmed the decision of the trial judge that 'the mortgage was vitiated by substantive injustice',[68] and limited the Tongs' liability to $105,000.[69] There were also elements of procedural injustice, including the quality of advice provided by the independent solicitor, however, these elements were not known to Esanda.[70]

[67] *Esanda Finance Corporation Ltd v Tong* (1997) 41 NSWLR 482 at 488.
[68] *Esanda Finance Corporation Ltd v Tong* (1997) 41 NSWLR 482 at 488.
[69] *Esanda Finance Corporation Ltd v Tong* (1997) 41 NSWLR 482 at 492.
[70] *Esanda Finance Corporation Ltd v Tong* (1997) 41 NSWLR 482 at 488.

In *Australia New Zealand Banking Group Ltd v Volemsky* [1994] Supreme Court of NSW, 15542 of 1992, BC9403395 (unreported, Spender AJ, 14 December 2004), Volemsky (a company shareholder and secretary) signed a guarantee and mortgage to secure advances made by the Bank to secure the original funds advanced to the company ($60,000); 'nothing else was in contemplation'.[71] In fact, the mortgage included an 'all moneys' clause.

Spender AJ found that there were both procedural and substantive considerations that made it appropriate for relief to be granted.[72] On substantive considerations, he referred to the fact that the documents used were difficult to understand,[73] and concluded that the inclusion of an all moneys provision was not reasonably necessary for the legitimate interests of the Bank.[74] However, procedural considerations were also important in granting relief.[75]

Similarly, in *St George Bank Ltd v Trimarchi* [2004] NSWCA 120 (20 April 2004), the Court of Appeal found that 'the loan conditions were not reasonably necessary for the legitimate interests of the either the appellant or the respondents'[76] because the mortgage and guarantee extended to secured repayment, not just of the principal sum borrowed, but also of the overdraft facility provided to the borrower's son for use in

[71] *Australia New Zealand Banking Group Ltd v Volemsky* [1994] Supreme Court of NSW, 15542 of 1992, BC9403395 (unreported, Spender AJ, 14 December 2004) at 31.
[72] *Australia New Zealand Banking Group Ltd v Volemsky* [1994] Supreme Court of NSW, 15542 of 1992, BC9403395 (unreported, Spender AJ, 14 December 2004) at 36.
[73] *Australia New Zealand Banking Group Ltd v Volemsky* [1994] Supreme Court of NSW, 15542 of 1992, BC9403395 (unreported, Spender AJ, 14 December 2004) at 36.
[74] *Australia New Zealand Banking Group Ltd v Volemsky* [1994] Supreme Court of NSW, 15542 of 1992, BC9403395 (unreported, Spender AJ, 14 December 2004) at 37.
[75] *Australia New Zealand Banking Group Ltd v Volemsky* [1994] Supreme Court of NSW, 15542 of 1992, BC9403395 (unreported, Spender AJ, 14 December 2004) at 37.
[76] *St George Bank Ltd v Trimarchi* [2004] NSWCA 120 (20 April 2004) at [10(r)].

his practice.[77] However, the injustice of these terms was not a significant matter in the overall decision.[78]

In contrast, in *Murphy v Overton Investments Pty Ltd* [2001] FCA 1725 (Unreported, Emmett J, 7 December 2001), the Court found that there was nothing unjust or unreasonable in terms requiring the lessees to pay legal and accounting costs, and to pay interest on monies borrowed or raised.[79]

Although these cases suggest that the existence of terms that are not necessary for the protection of the trader's legitimate interests might be used by Courts to provide relief for substantive injustice, a number of these cases seemed to have also involved procedural elements of unfair surprise.

Capacity to pay

A final example of substantive injustice is where the borrower does not have the capacity to meet the requirements under a loan contract, either at all, or without substantial hardship. In one sense, this is a subset of transactions that are structured in such a manner to generate an unjust result. However, given recent case law, it is worth considering this subset separately. In many cases, the fact that the borrower could not repay a loan was not enough for the contract to be considered unjust. 'Something more' is required, [80] and this 'something more' is often procedural injustice.

[77] *St George Bank Ltd v Trimarchi* [2004] NSWCA 120 (20 April 2004) at [55].
[78] *St George Bank Ltd v Trimarchi* [2004] NSWCA 120 (20 April 2004) at [70].
[79] *Murphy v Overton Investments Pty Ltd* [2001] FCA 1725 (Unreported, Emmett J, 7 December 2001) at [103], [108].
[80] *Mah v Esanda Limited (Commercial)* [2004] NSWCTTT 448 (25 August 2004) at [23], citing *Australian Society Group Financial Services (NSW) Ltd v Bogen* (1989) ASC 55-938. See also *Jones v Australia and New Zealand Banking Group Limited (ANZ) (Commercial)* [2004] NSWCTTT 381 (21 July 2004) for a case involving assessment of capacity to pay in relation to credit cards.

For example, in *Elkofairi v Permanent Trustee Co Ltd* [2002] NSWCA 413 (18 December 2002), an improvident loan was made and the Court of Appeal granted relief on the basis of both procedural and substantive factors:

> it [the transaction] was a substantial loan, security for which was the appellant's only asset – her interest in the property. The debt to asset ratio was almost 75%. Secondly, the respondent knew that the appellant had no income nor other assets … The consequence was … that the respondent was content to lend on the value of the security only. In my opinion, these factors taken into consideration with the matters to which I have referred in paragraph 53 [age, inability to read or write English, difficult domestic circumstances], are sufficient to make the contract unjust … and sufficient for the Court to exercise its discretion under s. 7.[81]

However, in the very recent case of *Small v Gray* [2004] NSWSC 97 (5 March 2004), the NSW Supreme Court found that, while there were procedurally unjust aspects of the loan contract,[82] 'there was no basis for thinking that the plaintiffs knew, or ought to have known, of any of the circumstances of procedural injustice'.[83] The party that may have been aware of the procedural injustice was not the agent of the lender.[84] In order to provide relief, the Court therefore had to rely primarily on the substantive injustice inherent in the contract:

> In summary, the transaction was improvident in the highest from Kristine's perspective. She received no part of the loan funds, and nothing of value by reason of their application. It put at risk

[81] *Elkofairi v Permanent Trustee Co Ltd* [2002] NSWCA 413 (18 December 2002) at [80]. See also *Arbest Pty Ltd v State Bank of New South Wales Ltd* (1996) ATPR 41-481 at 41,982 and 41,983, and *Millard v H&H Lobert Nominees Pty Ltd* (1998) ASC 155-011. In both cases, relief was granted in circumstances where the borrower did not have the capacity to meet the contract obligations, but there were also important elements of procedural injustice.
[82] *Small v Gray* [2004] NSWSC 97 (5 March 2004) at [88], [89].
[83] *Small v Gray* [2004] NSWSC 97 (5 March 2004) at [95].
[84] *Small v Gray* [2004] NSWSC 97 (5 March 2004) at [95]

> – at substantial risk – her dwelling and only asset of significance. It was inevitable that if she were called upon to perform her obligations, she would lose her dwelling. There was a real likelihood that she would be called upon.[85]

And the plaintiffs were, or should have been aware of the factors that pointed to substantive injustice.[86] Relief was granted.

There is some debate about the extent to which a defendant must be aware of the factors that lead to injustice for a successful claim under CRA.[87] However, it seems clear that in *Small v Gray*, the matter succeeded predominantly on the factors that were known to the lender, and these were all matters of substantive injustice. Similarly, in *Pasternacki v Correy* Matter No 12342/94 [1998] NSWSC 288 (7 August 1998), there were no enquiries of the guarantor's ability to pay, and relief was granted, even though it was unclear whether the lenders were aware of the procedural defects. [88]

Under the UCCC, a failure to assess capacity to pay is one of the factors that can be considered in determining whether to re-open an unjust transaction.[89] In *Lewis v Ormes* (Commercial) [2005] NSWCTTT 481 (18 July 2005), the lender's failure to make 'the necessary enquiries in respect of the applicants' ability to pay' was one of the factors that was determinative in its finding that the transaction was unjust.[90] Although they existed, procedural factors did not seem to play a large role. It seems therefore that the case law in this area may be developing towards a point where relief

[85] *Small v Gray* [2004] NSWSC 97 (5 March 2004) at [93].
[86] *Small v Gray* [2004] NSWSC 97 (5 March 2004) at [96] – [103].
[87] Carlin, 22 at 139–141.
[88] Carlin, 22 at 139–141.
[89] *Consumer Credit Code* s 70(2)(l).
[90] *Lewis v Ormes* (Commercial) [2005] NSWCTTT 481 (18 July 2005) at [28].

may be provided where the borrower has no capacity to repay, even though there may have been no obvious procedural irregularities.

What the cases show

This review of the case law suggests that there are some circumstances where a court *may* grant relief for substantive injustice in consumer credit contracts, even in the absence of procedural injustice. For example, the fact that a fee or charge is illegal might be a ground for relief. An 'horrendous disparity' in price or value might also be enough, although it is difficult to know what size the disparity needs to be before it is considered horrendous. Similarly, transactions structured so as to result in an unjust outcome might be sufficient to ground relief, including transactions structured in such a way that the borrower simply has no capacity to pay within its terms or where the lender is relying on the value of the security alone.

Finally, terms that are not reasonably necessary for the protection of the legitimate interests of the trader might be sufficient to ground relief. However, in this latter circumstances, courts seemed to have focused on cases where the lender received more security than it actually required or that the parties expected. These cases may therefore also have elements of unfair surprise and procedural injustice.

The suggestion that courts will not provide relief for substantive unfairness unless there is also procedural unfairness receives support from a review of consumer credit cases as the cases providing relief for substantive unfairness seem to be in the minority, and many decisions continue to place high reliance on procedural issues in order to grant relief. Given the difficulties and costs for individual consumers in

litigating on consumer protection legislation,[91] prudent legal advice would be to commence litigation seeking relief from unjust contracts or transactions only where there is an element of procedural injustice.

Intervening in consumer contracts: the theoretical basis

As noted earlier, classical contract theory is based on the notion of freedom of contract. The traditional and classical basis of contract law takes a fairly firm stance that courts should not interfere with contract terms, no matter how one-sided. Contracts come into being once a bargain is struck between the parties, and the need for certainty of contract between parties has resulted in a strong reluctance on the part of the judiciary to 'go behind a concluded and certain bargain'.[92] The traditional model of contract rests on the notion that parties are free to make whatever bargains they like, even if those bargains are (or might appear to be) patently against their own interests. Freedom of contract is therefore generally subject only to the parties having capacity to contract, and there being no illegality or other procedural defects.[93]

Gradually, however, this strict application of classical contract law has been whittled away, not only through the implementation of the consumer protection provisions summarised above, but through more specific legislative provisions that imply

[91] Malbon suggests that 'it is time consuming, expensive and just plain risky for a consumer to contest a provision under section 70 in a court or tribunal': Malbon J, "Predatory Lending" (2005) 33 ABLR 224 at 237.
[92] Victorian Bar Council, n 5 at 27.
[93] For example, Smith SA "In Defence of Substantive Unfairness" (1996) 112 *Law Quarterly Review* 138 at 145.

specific terms into consumer contracts, regardless of the wishes of the parties.[94] These more recent interventions have generally been based on the differential in bargaining position between consumers and traders, the need for consumers to be accorded greater protections, and the rise and rise of the standard form contract in consumer dealings. However, as Duggan has noted, the theoretical rationale for these types of interventions in the name of consumer protection is not always clear.[95] Duggan suggests that theoretical frameworks for consumer protection inventions might reflect welfare considerations, equity considerations, or 'paternalism'.[96] Others have proposed different and competing approaches. For example, Howells suggests that there are broadly three consumer protection rationales for intervention into freedom of contract: promoting competition, achieving individual justice, and realising social justice.[97] And in their development of 'information-based principles' for consumer protection policy, Hadfield et al focus on an economic conception of the objectives of consumer protection.[98] In contrast, Ramsay talks of a 'third way' approach to consumer credit regulation, that both recognises the importance of the market, and of empowering consumers within that market, and also focuses on the relevance of social policy in achieving goals that cannot be met relying on the market alone.[99]

These differing approaches show that work is still needed to develop an appropriate and coherent theoretical framework for consumer protection laws in Australia. At the

[94] For example, *Trade Practices Act 1974* (Cth), Division 2 – Conditions and warranties in consumer transactions.
[95] See Duggan A, "Saying Nothing with Words" (1997) 20 *Journal of Consumer Policy* 69 at 77-79.
[96] Duggan A, 'Some Reflections on Consumer Protection and the Law Reform Process" (1991) 17 *Monash University Law Review* 252 at 254.
[97] Howells GG, "Contract Law: The Challenge for the Critical Consumer Lawyer" in Wilhelmsson T (ed) *Perspectives of Critical Contract Law* (Dartmouth, 1993) 327, p 335.
[98] Hadfield G, Howse R, and Trebilcock MJ, "Information-Based Principles for Rethinking Consumer Protection Policy" (1998) 21 *Journal of Consumer Policy* 131 at 132.
[99] Ramsay I, 'Consumer Credit Regulation as "The Third Way"?' (Speech delivered to the Australian Credit at the Crossroads Conference, Melbourne Australia, 8 November 2004), at 5.

same time, given the centrality of contracts to consumer transactions, a new theory of contract law needs to be developed, one that can accommodate the changing attitudes of regulators, governments and courts where consumer dealings are concerned.[100] In our current model, consumer protection interventions merely chip away at the edges of classical contract law, whilst leaving the basic principles of freedom of contract intact and treated as the norm. This, in large part, is the reason that courts and tribunals have been reluctant to provide relief for substantive unfairness in consumer contracts (as shown above). To do so would bring into question the overriding principle of freedom of contract. For example, under the *Contracts Review Act 1980* (NSW), the 'public interest' must be considered in assessing a case for relief for unjust contract, and the courts have held that it is a matter of public interest that parties keep to their bargains.[101]

As shown in the next section, however, the applicability of the assumptions and rationales behind freedom of contract and classical contract law can be questioned in the context of consumer transactions. A new framework for consumer contracts that takes an inequality in bargaining power, and a lack of negotiation on contract terms as starting points, rather than as exceptions to the norm, is urgently needed. A regime that provides clear statutory relief for terms that are substantively unfair may be the first step to developing such a framework.

[100] See for example, Collins H, "Regulating Contract Law" in Parker C, Scott C, Lacey N, and Braithwaite J (eds) *Regulating Law* (Oxford University Press, 2004), p 12 – 32.
[101] *Baltic Shipping Company v Dillon "Mikhail Lermontov"* (1991) 22 NSWLR 1 at 9 (Gleeson J), 20 (Kirby J).

Why do consumers need relief from substantive unfairness?

Summarised above are the rationale and theories behind classical contract law that have, in the author's view, led to a reluctance by courts and tribunals to provide consumers with relief from substantive unfairness. There are important public policy reasons for a strong focus on freedom of contract:

- Certainty of contract facilitates commerce – it allows parties to demonstrate their credibility at low cost.[102]
- It is likely to be very difficult for an external party to make an assessment of what is a reasonable price, or a reasonable term, particularly when the adjudicator is unfamiliar with the relevant market.
- Certainty of contract facilitates individuals using their own skills, expertise, and bargaining power to their own advantage.

In addition, there can be a whole range of reasons for an individual or company to enter into what might objectively look like an improvident contract. Again, it can be argued that it would not be easy (or appropriate) for an external party to make an assessment of the validity of those reasons.

Underpinning the reliance on notions of freedom of contract are assumptions that contracts reflect the will of the parties, that negotiation on terms occurs, and that, even if traders are tempted to use unfair contract terms, the high level of competition in consumer markets will operate to dissuade the use of unfair terms. However, the

[102] Goddard, n 14 at 127.

reality of consumer contracting today suggests that these assumptions need to be questioned.

Most consumer contracts, including consumer credit contracts, are standard form contracts. The trader develops the contracts, in isolation from consumers, with little or no negotiation on the terms of the contract. They are usually offered on a 'take it or leave it' basis, and the concept of two parties negotiating on the terms of the agreement is therefore largely illusory.[103] The terms of the contract reflect the wills of both parties in only the most abstract of senses. One commentator has gone so far as to suggest that:

> the contractual process is weighted against consumers, and weak consumers in particular, and equally traditional contract doctrine based on notions such as freedom of contract support these inherently unequal bargaining structures.[104]

There is nothing inherently wrong with standard form contracts. They can substantially reduce the transaction costs for all parties to the contract,[105] and can help large businesses (in particular) to ensure that contracts issued from a number of outlets will be consistent with each other, and with legal obligations.[106] However, the use of standard form contracts means that the theoretical ideal of freedom of contract cannot be reached. Consumers have only two choices - to purchase on the terms

[103] In its submission to the SCOCA Discussion Paper, the Australian Bankers Association refers to 'the supposition that contractual terms in respect of banking contracts might be individually negotiated', and suggests that 'it would be impracticable (a near impossibility) and cost prohibitive for banking services contracts to be individually negotiated'; Australian Bankers Association, *Submission to Unfair Contract Terms Discussion Paper* (2004) pp 9-10, http://www.fairtrading.qld.gov.au/oft/oftweb.nsf/AllDocs/CB0A9D21A156FEDF4A256ED1000ADCC7/$File/Subm%20ABA%20(67).pdf, viewed 25 October 2005.
[104] Howells, n 96 at 328.
[105] Duggan and Lanyon, n 26 p 362.
[106] Australian Bankers' Association, n 102 p 3.

imposed by the trader, or not to purchase at all. There is no middle ground, with the terms of trade up for negotiation or discussion. Choice is reduced even further, when, as is common in the financial services sector, there is little practical difference between the terms and conditions offered by each of the competitors in the market, and unfair terms are replicated across an industry.

One response to this lack of opportunity for negotiation might be to provide an opportunity for consumers to negotiate on the terms of a transaction. However, the practical costs of imposing such a requirement are likely to outweigh any perceived benefits.[107]

The assumption that competitive markets will drive out unfair terms is also questionable. For competitive markets in terms and conditions to exist, at least some consumers need to be reading the terms and conditions, and using the terms and conditions to choose between potential suppliers. However, in reality, it is likely that few consumers read their contracts in any detail prior to signing.[108] The expanding literature on behavioural economics and consumer decision-making suggests that consumers act under conditions of bounded rationality, where 'they rationally trade off the costs of search with the benefits yielded by gaining extra information'.[109]

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[107] Zumbo, n 10 at 75.

[108] See Consumers Federation of Australia *Submission to the Standing Committee of Officials of Consumer Affairs Working Party on Unfair Contract Terms*, p 2, http://www.fairtrading.qld.gov.au/oft/oftweb.nsf/AllDocs/CB0A9D21A156FEDF4A256ED1000ADCC7/$File/Subm%20CFA(71).pdf, viewed 25 October 2005. Sovern also provides a range of reasons why consumers do not read contracts: Sovern J "Towards a New Model of Consumer Protection: The Problem of Inflated Transaction Costs" (January 2005), St John's Legal Studies Research Paper No 05-002, http://ssrn.com/abstract=648052, viewed 2 August, 2005, pp 30 -34.

[109] McAuley I, "Unfair contracts – an economic perspective" (2004), unpublished paper, p 3. See also Ramsay (2004), n 98 p 15; Ramsay I, *Access to Credit in the Alternative Consumer Credit Market*, paper prepared for: Office of Consumer Affairs, Industry Canada, and Ministry of the Attorney General, British Columbia (2000), at 23-24, http://cmcweb.ca/epic/internet/incmc-cmc.nsf/vwapj/ramsay_e.pdf/$FILE/ramsay_e.pdf, viewed 20 June 2005.

Where the costs of obtaining the information is high because the contract is long, complex, and full of 'legalese' (as is the case for many consumer contracts, particularly in the financial services sector), the cost-benefit analysis will tend to operate in favour of not reading the contract. This tendency is even greater where consumers know or assume that the terms are similar between different traders,[110] and there is no opportunity for changing the terms in any case. In addition, many consumers have low levels of general and financial literacy, [111] and may be 'systemically unable to process the information they need to make good decisions'.[112] For example, in 1999 research, Malbon reported that many consumers found comparing loan terms difficult; and many only focused on headline information (such as the interest rate) to choose between home loan providers.[113]

Even if some consumers may read at least the key terms of a contract, it is likely that most would put a favourable spin on their own intentions and capabilities to meet the terms of the contract. Individuals are 'unduly optimistic about their own susceptibility to risks'.[114] In the case of credit contracts, for example, consumers will not expect to default. They may therefore be less inclined to examine the contract terms that explain what will happen in the event of a default, or other similar 'back-end clauses'. In contrast, the trader has vast experience in the likelihood or otherwise of certain events happening, and is much better able to assess the risks to its business of a particular transaction, and to price it accordingly.

[110] For example, a term allowing unilateral variation of a credit contract by the lender is likely to be found in all home mortgage contracts.
[111] See Roy Morgan Research *ANZ Survey of Adult Financial Literacy in Australia Final Report* (2003).
[112] Hadfield et al, n 97 at 145.
[113] Justin Malbon (1999) *Taking Credit: A Survey of Consumer Behavior in the Australian Consumer Credit Market*, p 12 – 13.
[114] Ramsay (2000), n 108 at 23.

If most consumers do not read contracts, and/or use the terms of contracts to choose between potential suppliers, competition between suppliers is unlikely to force the use of fairer terms. In fact, with very limited exceptions (usually in relation to refund policies), traders do not appear to compete on their terms and conditions.[115] This lack of competition in contract terms means that there is little to operate as a counterweight to a trader's tendency to draw up contracts that favour the trader.[116] The absence of competition, or consumer scrutiny, on terms also means that there is little incentive or reward for traders who use fair terms. Where consumers are focused on price, traders can reduce the price by shifting risks to consumers through the fine print, and the market can create a situation where bad (unfair) contracts drive out good (fair) contracts.[117]

A system that assumes negotiation and competition to ensure consumer contracts fairly balance the rights and responsibilities of the parties, the traditional doctrine of contract law does, is bound to fail most, if not all, consumers. In contrast, a system that prohibits traders from taking advantage of a consumer's lack of bargaining power by imposing terms that unfairly distribute the risks in the trader's favour is likely to drive the development of fairer consumer contracts.

There are other potential benefits for implementing unfair contract terms legislation. For example, providing for relief for substantive unfairness can also provide a systemic solution to unfairness. Consumers are vulnerable as a class to unfair terms,

[115] Field C "The Death of Unfair Contracts" (2004) 29(1) Alternative Law Journal 35 at 35.
[116] Hadfield et al, n 97 at 142, suggest that, among other things, standard form contracts can be a method for shifting terms of trade in favour of sellers.
[117] Sovern, n 107 at 28 – 29.

due to inequalities in bargaining power, and behavioural tendencies. Thousands of consumers can be adversely affected by an unfair term in a contract. A regime that prohibits substantive unfairness can mean that the finding in one case that a term was unfair can often automatically be applied to all other affected consumers.[118] In contrast, a regime that focuses on procedural unfairness normally requires separate litigation for each affected consumer, as the procedural irregularities may differ from one consumer to the next. The costs and hurdles for consumers taking individual legal actions can be very high, with the result that, in some cases, legal rights will not be pursued and unfair practices may continue unchecked.

Prohibiting substantive unfairness in consumer contracts can also have a positive impact on consumer trust in markets. In the absence of regulations prohibiting unfair contract terms, consumers must rely on a trader having sufficient concern for its reputation that it will either exclude unfair terms from contracts,[119] or decide not to enforce unfair terms.[120] However, consumers have low levels of satisfaction in financial institutions, particularly the major banks,[121] and this disillusionment can lead to a lack of trust that the institutions are looking out for their customers' interests. In the long term, unfair contract terms can create distrust between consumers and traders. According to McAuley, two adverse economic consequences flow from a lack of trust: some transactions will not occur at all; and for those transactions that do

[118] For example, under the Victorian legislation, the Tribunal can grant an injunction preventing the use of an unfair term: Fair Trading Act 1999 (Vic), s 32ZA.
[119] Malbon, n 90 at 237.
[120] For example, the Australian Bankers Association, n 102 p 10, suggests that provisions in the Code of Banking Practice requiring banks to act fairly and reasonably would preclude unfair reliance on contract terms.
[121] Reporting on their latest banking satisfaction survey, the Australian Consumers Association noted that: "The 'Big Four' banks are the clear losers when it comes to customer satisfaction": Australian Consumers Association, *Choice Money & Rights* No 7 April/May 2005, at 12.

occur, their benefit will be diluted by high transaction costs.[122] Diminishing trusts in markets therefore imposes economy-wide costs, making an economic case for regulation to prohibit unfair terms.[123]

Critics of unfair contract terms legislation suggest that a regime that allows a consumer to challenge a contract after the fact negatively impacts on certainty and business planning.[124] There is some merit in this argument, and at the end of this article, some suggestions are made to facilitate certainty of contract in a regime that prohibits unfair terms. However, it is also important to note that, most consumers make their decisions based on a limited understanding of the terms and conditions of contracts, and the expectations created by traders through advertising and sales communications. In this context, a trader's reliance on a disadvantageous (to the consumer) term in the fine print also upsets certainty of the consumer's understanding of the contract.[125] This is even more the case for products where the terms are part of the specifications of the product.[126]

Critics also suggest that it is not appropriate to consider apparent unfair terms in isolation from other terms in the contract.[127] In any contract, a term that is heavily

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[122] McAuley I, 'But do we need the Nanny State' (2004) 101 *Consuming Interest* 8 at 9.
[123] McAuley, n 121 at 9.
[124] For example, Masters Builders Association *Submission to Unfair Contract Terms Discussion Paper* (2004) p 7, http://www.fairtrading.qld.gov.au/oft/oftweb.nsf/AllDocs/CB0A9D21A156FEDF4A256ED1000ADCC7/$File/Subm%20MBA_59_.pdf, viewed 25 October 2005.
[125] For example, after referring to the fact that traders send out signals about quality of performance through advertising, presentations, responses to enquiries etc, Willett 1996 suggests that: "Perhaps we can say that terms are potentially unfair or unreasonable partly because they may offer something less than what is reasonably or legitimately expected. It may not be acceptable for businesses to use such terms because they have been responsible for the creation of the expectations in the first place." Chris Willett C, "Introduction – The Scope of the Collection" in Willett C (ed), *Aspects of Fairness in Contract* (Blackstone Press, 1996), p 21.
[126] Griggs, n 10 at 2.
[127] For example, Telstra Corporation Ltd *Submission to Unfair Contract Terms Discussion Paper* (2004) p 23 – 24,

weighted towards the trader might be balanced by a term heavily weighted towards the consumer,[128] or an apparently unfair term might enable the trader to provide services to high-risk consumers.[129] In practice, however, most regulatory regimes that provide relief for substantive unfairness require the decision maker to look to at all the circumstances.[130] For example, the regulations in the UK require the unfairness of a term to be assessed by referring, among other things, to 'all the other terms of the contract or of another contract on which it is dependent'.[131] Thus, terms reasonably needed to protect the trader when servicing high-risk consumers are unlikely to be at risk under unfair contract terms regimes.

However, reasonableness is the key. This means that the steps taken by the trader to protect its interests must not be disproportionate to the actual risks incurred. So, for example, the practice of securing a personal loan with a mortgage over basic household furniture, which is protected by bankruptcy legislation and also court enforcement processes, and where the costs of repossessing are likely to significantly outweigh the likely revenue on sale, could be argued as not reasonably necessary for the protection of the lender's interests.[132]

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http://www.fairtrading.qld.gov.au/oft/oftweb.nsf/AllDocs/CB0A9D21A156FEDF4A256ED1000ADCC7/$File/SubmTelstra%20(23).pdf, viewed 25 October 2005; Housing Industry Association *Submission to Unfair Contract Terms Discussion Paper* p 11-12, http://www.fairtrading.qld.gov.au/oft/oftweb.nsf/AllDocs/CB0A9D21A156FEDF4A256ED1000ADCC7/$File/Subm%20-%20HIA_20_.pdf, viewed 25 October 2005.

[128] However, given that contracts are written entirely by traders (or their solicitors), it would probably be rare to find terms in a contract that are heavily weighted in favour of consumers, with the exception of consumer-favouring terms that are required by legislation or an industry code.

[129] Hadfield et al, n 97 at 147. Zumbo, n 10 at 73, also talks about possibility of trade-offs and offsetting rewards in consumer contracts as being supportable if the offsetting reward is reasonably proportionate to the disadvantage.

[130] *Fair Trading Act 1999* (Vic) s 32W; *Unfair Terms in Consumer Contracts Regulation 1999* (UK) reg 6(1).

[131] *Unfair Terms in Consumer Contracts Regulation 1999* (UK) reg 6(1).

[132] Consumer advocates have called this a practice of taking 'blackmail securities', because the creditor simply relies on the threat of repossessing furniture in order to 'encourage' the debtor to prioritise their debt over any others. See Consumer Credit Legal Centre (NSW) Inc., Consumer Credit Legal Service Inc. (Vic), Consumer Law Centre of the ACT, and Consumer Law Centre Victoria *Joint Consumer*

Contract law principles derive from assumptions of parties coming together to negotiate an agreement acceptable to both parties. However, the circumstances of consumer transactions are very different, and the direct application of traditional contract law principles to consumer contracts has therefore has been modified over time, including by restricting the freedom of parties to include certain terms in contracts. Given the growth in consumer contracting, the increasing complexity of transactions, the fact that terms are unilaterally set by traders, and the lack of market incentives upon traders to ensure terms are fairly balanced, a more extensive regime prohibiting unfair terms in consumer contracts is needed. A new framework, based on substantive unfairness, could start from the perspectives and realities of consumers. It could take as a given the fact that many traditional contract law principles are not appropriate for consumer contracting, and could be a basis for 'a broader based theory underpinned by the principle of inequality of bargaining power'.[133]

Ultimately, such a framework will result in fairer, and more efficient outcomes for consumers and ethical businesses.

Submission regarding The Ministerial Council on Consumer Affairs' Discussion Paper on Long Term Regulation of Fringe Credit Providers (October 2003), p 5, www.consumersfederation.com/documents/FringeCreditSubmissionOctboer2003.pdf, viewed 2 August 2005.

[133] Howells, n 96 at 332.

Conclusion and options for reform

This article has argued that the reality of consumer transactions provides a strong case for prohibiting substantive unfairness in consumer contracts. A substantively unfair consumer contract is not one that the law should support.[134]

There are statutory provisions that, in theory, appear to be able to provide relief for substantive injustice, even in the absence of procedural injustice. However, in practice, it appears that the courts and tribunals continue to be wary of providing relief in circumstances where there is no procedural injustice. The cases where relief seems to have been granted on the grounds of substantive unfairness are small in number, and not all are certain in their precedent value. In part, this reluctance reflects the continuing dominance of notions of freedom of contract, and of contracts resulting from negotiations between the parties. These understated principles persist even in consumer transactions, dominated by standard form contracts offered on a take it or leave it basis.

Regulatory change is therefore needed, and such change needs to involve more than further tinkering around the edges of contract law. Otherwise, there is a risk that any new developments will continue to be influenced by classical contract theory, and fail to develop to their full potential. Ultimately, a new and consistent theory of the interactions between consumer protection and contract law is needed. This is a project that is beyond the scope of this article, however, national, or nationally uniform,

[134] That is, evidence of substantive unfairness should be added to Goddard's reasons for intervening in contracts: see Goddard, n 14 at 135.

legislation to prohibit unfair contract terms in consumer contracts could be one step in the necessary journey.

One option would be to introduce legislation along the lines of the EU Directive, UK Regulations, and Part 2B of the *Fair Trading Act 1999* (Vic) – applicable to all consumer contracts.[135] It has also been suggested that, instead of creating a completely new legislative framework, there should be consolidation and expansion of existing provisions, so that it is clear that relief can be granted where there is procedural injustice, substantive injustice, or both.[136] It is interesting to note that the Law Commission and Scottish Law Commission in the UK have recently recommended a draft Bill to introduce a single unified regime to replace the *Unfair Terms in Consumer Contracts Regulations* and the earlier *Unfair Contract Terms Act*.[137]

In order to assist with certainty of contract, such a legislative framework could also provide for the regulator or legislature to prescribe specific terms as unfair and prohibited from use in consumer contracts.[138] Greater certainty can also be achieved by providing for a regime of 'fair terms' that could be excluded from the unfair terms regulation.[139] Effective industry codes might be one means of generating fairer terms. For example, the Electronic Funds Transfer Code of Conduct has established fair terms for the allocation of liability between the consumer and their financial

[135] SCOCA, n 1 p 43-46 (Option 3).
[136] SCOCA, n 1 p 48-49 (Option 5).
[137] Law Commission and Scottish Law Commission *Unfair Terms in Contracts*, (2005) Law Commission Report no 292, Scottish Law Commission Report No 199.
[138] The Victorian legislation allows for terms to be prescribed as unfair by regulation: *Fair Trading Act 1999* (Vic) s32U. However, as at the date of preparing this article, no such regulations had been passed.
[139] For example, the Victorian legislation does not apply to contractual terms that are required or expressly permitted by law, but only to the extent required or permitted (*Fair Trading Act 1999 (Vic)* s 323V(b)).

institution in the event of a disputed electronic funds transfer.[140] This approach would be an extension of what is already present in the Victorian legislation, where section 32V(b) provides that a term is not unfair if it is expressly required or permitted by law, but only to the extent expressly permitted or required.

Of course, parameters would need to be established to ensure that ineffective self-regulation is not used as a mechanism for avoiding the prohibition against unfair terms. One option might be to give the regulator power to assess codes and other instruments, and determine whether the proposed provisions do represent 'fair' outcomes, and whether it would be appropriate to exempt them from unfair terms legislation. Such an assessment would have to look at the extent to which there was consultation and agreement amongst stakeholders that the terms represented a fair balance of the rights of the parties; as well as the extent to which the code was supported by appropriate infrastructure, including compliance and enforcement mechanisms, broad industry coverage, and strong industry commitment. There would also have to be provision built in to ensure that fair terms do not become outdated in light of changing technologies, consumer behaviours, and community expectations.

The Australian Securities and Investments Commission already has powers to approve industry codes of conduct,[141] and the Commonwealth Government can prescribe industry codes of conduct under Part IVB of the *Trade Practices Act 1974*

[140] Electronic Funds Transfer Code of Conduct (2001), section 5.
[141] See *Corporations Act 2001* (Cth) s 1011A, and ASIC Policy Statement 103 *Approval of financial sector codes of conduct*, 2005.

(Cth).[142] These powers could perhaps be used to form a starting point for an approach along these lines.

An alternative framework might provide that certain terms are presumed unfair, but validated if there is evidence of procedural fairness. For example, a term could stand if the trader could demonstrate that the term was specifically explained to the consumer, in circumstances where it was likely that they would have understood its import; or the consumer received independent legal and/or financial advice.[143] Such a response would also deal with the objection to unfair terms that they are 'hidden terms'.[144] However, this approach suffers from the perception that information asymmetry is the only problem with unfair terms, and that proper disclosure will be a suitable remedy. This is not the case, and there is a risk with this approach that it will permit unfair terms to be enforced against vulnerable or disadvantaged consumers, who have little choice or bargaining power in the market. Given this, an approach along the lines of the Victorian or European legislation is preferred.

Legislation to prohibit unfair terms in consumer contracts is urgently needed. Without regulatory change, consumers will continue to be at the mercy of traders seeking to transfer risk or costs to them through unfair terms, with all the individual, economic and social costs that this imposes.

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[142] See also Australian Competition and Consumer Commission, *Guidelines for developing effective voluntary industry codes of conduct* (February 2005).
[143] Although there have been problems identified in respect of independent legal advice to guarantors: N.S.W Law Reform Commission (2003)*Darling, please sign this form: a report on the practice of third party guarantees in New South Wales- Research Report 11* p 86-98.
[144] See also the 'ordinarily prudent consumer' test proposed by Malbon, n 90 at 239.